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The ECONOMIC and FISCAL UPDATE

Overview



November 16, 2004



Canada



Highlights

- The Canadian economy rebounded strongly in 2004 following a series of shocks in 2003. The resilience of the Canadian economy reflects Canada's strong fiscal and monetary policy framework.
- Private sector forecasters expect the Canadian economy to grow by 3 per cent in 2004 and 3.2 per cent next year.
- The Government remains committed to achieving balanced budgets or better in each of the next five years. Projections in this Update show planning surpluses this year and for the next five years—after accounting for recently announced major increases in health and other transfers to the provinces and territories, and after setting aside normal prudence.
- A comprehensive third-party expert review of the Government's economic and fiscal forecasting is underway to ensure that the Government is using best practices and benchmarking itself against the very best in the world.

Canada's Resilient Economy

Canada's economy has rebounded strongly in 2004, and is expected to exceed growth forecasts made earlier this year. Indeed, the Canadian economy grew at an annualized rate of 3.4 per cent in the first half of this year—up from 2 per cent in 2003.

This strong rebound has produced a number of favourable results for Canadians. For example:

- Nearly 400,000 new full-time jobs have been created since August 2003.
- Exports recovered well from last year's sharp rise in the Canadian dollar, growing at an annual rate of 21 per cent in the second quarter of 2004.

■ Canada's current account surplus stood at \$42 billion in the second quarter—it's second highest level ever.

■ Investment in new machinery and equipment has increased by nearly 9 per cent during the last year, reflecting strong business confidence.

Stronger Global Economic Growth

Major global economic forecasting agencies such as the International Monetary Fund (IMF) are predicting stronger world economic growth in 2004 and 2005.

- Surging economic growth in China has stimulated the economies of many of its Asian neighbours, including Japan and Korea, while spurring strong demand for Canadian and other resources.
- The economic recovery in Europe is gaining a firmer footing but remains uneven.
- U.S. economic growth slowed in the second quarter of 2004, but early indications show that growth picked up in the third quarter, and solid growth is forecast for next year.

Overall, the IMF predicts the global economy will expand by 5 per cent in 2004 and 4.3 per cent in 2005. However, high oil prices could have a dampening effect on global growth. As always, unforeseen geopolitical events could also have negative effects.

Canadian Economic Outlook

Private sector economists surveyed by the Department of Finance expect solid economic growth for Canada in 2004 and 2005. They expect growth to be 3 per cent in 2004, higher than forecast in the March 2004 budget, rising to 3.2 per cent in 2005.

Several factors pose downside risks to these forecasts:

- In the short term, oil prices could stay high or rise further, reducing the purchasing power of oil consumers in Canada and elsewhere.
- As well, further appreciation of the Canadian dollar could dampen growth, particularly if the dollar's rise proves to be more a result of the rising U.S. current account deficits with Canada and other countries, rather than high commodity prices.
- In the medium term, the large U.S. budget deficit could put upward pressure on interest rates or lead to spending cuts or tax increases in the United States, which would negatively affect Canada's largest export market.

Canada's Fiscal Outlook

Average Private Sector Projections

The average private sector projections of the fiscal surplus for planning purposes are as follows:

2004–05:	\$5.9 billion
2005–06:	\$500 million
2006–07:	\$900 million
2007–08:	\$3.2 billion
2008–09:	\$7.5 billion
2009–10:	\$11.5 billion

These surpluses—totalling \$29.5 billion—were arrived at after subtracting the annual \$3-billion Contingency Reserve and additional economic prudence.

In addition, these surplus projections take account of the recently announced new funding of nearly \$75 billion over 10 years for health, equalization and Territorial Formula Financing (TFF) agreed to at the First Ministers' Meetings in September and October 2004.

The cost of the 10-Year Plan to Strengthen Health Care and the new framework for equalization and TFF amounts to \$3.6 billion in 2004–05, rising to \$6.7 billion in 2009–10. The surplus projections also take into account other spending decisions since the 2004 budget, primarily for assistance to the cattle and beef industry.

However, the planning surplus does not include any savings from the Government's expenditure review process, which is currently underway and should be completed in time for the next federal budget.

Sound Fiscal Management— A Virtuous Circle

Ten years ago Canada was in a vicious circle of annual budget deficits and rising debt, high interest rates, high taxes, sluggish economic growth and lost jobs. Interest on the federal debt absorbed 38 cents of every dollar the Government took in.

Today this vicious circle has been replaced by a virtuous circle. After seven consecutive federal surpluses, Canada now enjoys the benefits of a declining debt burden, a solid credit rating, low interest rates, lower taxes, consistently strong economic performance and the best rate of job creation among Group of Seven (G-7) countries. Instead of paying 38 cents of every revenue dollar to service the debt, the Government now pays about 19 cents.

Greater Accountability and Value for Money

The Government is delivering on its commitment to provide greater accountability, transparency and value for taxpayer dollars by:

- Re-establishing the Office of the Comptroller General to oversee all aspects of spending.
- Strengthening internal audit capabilities through comprehensive program audits.
- Making government contracts available for public scrutiny.
- Continuing its expenditure review process with the goal of reallocating \$12 billion over the next five years from low- to high-priority programs.

Challenges of an Aging Population

Canada's aging population poses two key challenges for our society.

- It will put pressure on social programs such as health care and public pensions.
- The shrinking share of the population in the workforce will increase Canada's reliance on productivity gains to maintain the continuing growth in the nation's standard of living.

Reforming and Strengthening Social Programs

The Government of Canada has recently reached long-term agreements with the provinces and territories on health care funding for the next 10 years. These agreements call for reforms focused on the needs of patients to ensure that all Canadians have access to the health care services they need, when they need them.

To ensure that our publicly funded pension plan remains intact for the next generation of working Canadians, the Government has also taken steps to ensure the viability of the Canada Pension Plan for the next 50 years, making Canada one of the few countries in the world with a solid public pension plan.

Finally, the Government has substantially reduced the federal debt. In this regard, it will continue to maintain balanced budgets or better and work towards achieving its goal of reducing Canada's debt-to-GDP (gross domestic product) ratio to 25 per cent within 10 years.

Building a More Productive Economy

The Government is moving to address the productivity challenge by maintaining the right macroeconomic framework of balanced budgets, debt reduction, as well as low and stable inflation.

By emphasizing education and lifelong learning, coupled with incentives to promote research and innovation, the Government aims to maintain and improve the "education advantage" that Canada now enjoys.

The Government also recognizes that a key to improving Canada's productivity is to create a more competitive environment that rewards entrepreneurs and offers every Canadian the opportunity to achieve their goals in this country.

Making our economy more productive also requires ongoing efforts to ensure that Canada's tax environment is as fair and competitive as possible. The Government will therefore look at ways to reduce taxes, particularly for low- and middle-income Canadians.

**How can I get more information
on the 2004 Economic and Fiscal Update?**
Information is available on the Internet at:
www.fin.gc.ca

You can also obtain copies of this brochure or other Update documents from:

Distribution Centre
Department of Finance Canada
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